

Conference Call Transcript with Mr. Sidhant Gupta – Director, Kwality Dairy (India) on 14th February 2012

Presentation Session

- Moderator: Ladies and gentlemen, good day and welcome to the Q3 FY'12 Earnings Conference Call Kwality Dairy (India) Ltd hosted by Almondz Global Securities Limited. As the remainder for the duration of this conference all participants' line will be in the listen-only mode. There will be an opportunity for you to ask questions at the end of today's presentation. Should you need assistance during this conference please signal an operator by pressing "*" and then "0" on your touchtone telephone. Please note that this conference is being recorded. At this time I would now like to hand the conference over to Mr. Harjit Singh Sethi from Almondz Global Securities Limited, thank you and over to you Sir.
- Harjit Singh Sethi: On behalf of Almondz Global Securities Limited, we welcome you all for the Q3 FY'12 earnings conference call of Kwality Dairy Limited. We have with us Mr. Sidhant Gupta, Director and other members of the management team. I would like to hand over the proceedings to Mr. Gupta to take us through this quarter performance and some details of the latest developments at Kwality, over to you Sir.
- Sidhant Gupta: Thank you Harjit ji, Good morning Ladies and gentlemen and thank you for joining us today to discuss the quarterly results of Kwality Dairy India Limited. I will just quickly start in the quarter ending December 2011, the company's net sales increased by 43% to 642 Crores from 449 Crores in the corresponding period last year therefore in the first nine months of the year our turnover today stands at 1640 Crores and we have already surpassed the total sale of last year which was at 1608 Crores. Our EBITDA for the quarter increased by 45% to 46 Crores as compared to Rs. 32 Crores in Q3 FY'11. Profit after tax for the quarter ended stood at 22.32 Crores as compared to 17.69 in Q3 FY'11 thereby registering an increase of almost 26% let me also take you through the key developments that the company did in the last quarter, the most important of it was the launch of Dairy Best Nutrified milk. We have launched pouched liquid milk under the brand Dairy best in the NCR market towards the last week of December 2011. We are pleased to inform that we have been able to touch a remarkable figure of approximately 1.5 lakhs liters per day in just one-and-a-half month of our launch. We expect the milk sale to touch approximately 5 lakhs liters per day in next 2 to 3 quarters and thereby completely replacing the unbranded milk sale that we used to do earlier. This will significantly reduce our working capital requirement for the milk segment in the coming quarters as we do not have to extend much credit in this case unlike in case of the unbranded loose milk that we were selling in tankers. Branded milk sale will also help us improve the gross margin of the company. The USP of this product is that we nutrified it with calcium vitamins A and D, so that has been the differentiator in our product. The other thing that we did was the launch of thick curds that was done in the consumer pack and also in the bulk pack. The company launched branded pouched and set curd in the NCR market in November 2011 and there has been a very good response to the curd launch, we have been already able to touch almost around six tonnes per day for the bulk pack that goes mainly to the caterers and the restaurants and the hotels. We have also got our brand registered with IRTC that is the Northern Railways and in fact you can find our curd in 80 grams in most of the Shatabdi and Rajdhani. The company is consistently working to build a strong distribution network in the NCR market to push the branded value added products that had been the vision to move from the institution products to the branded consumer product. Another launch that we did was the Dairy Best cottage cheese. The company launched the cottage cheese in the NCR market that was also done in November 2011 along with curd and there has again been a very good response, we are already touching almost between 2.5 to 3 tonnes per day and all that in just three months of launch. These are all in 200 grams and 400 grams pouches and we are consistently working to build a strong distribution network in the NCR market to push our branded value added products. The focus in the coming times is

moving from the institutions to the consumer value added products. Now another interesting thing that I would like to share here is we opened a mega chilling center in Ajmer, which was done in January where we have been able to source almost one lakhs liters of milk directly from almost around 25000 farmers. Generally, a milk-chilling center is good to source about 20,000-25000 liters of milk per day but here in this case this has been the second largest milk-chilling center in India where within just two months of operation we have been able to gather 1 lakh liters, now that has been a fantastic response to that area and our focus in Rajasthan is increasing and we will be opening many more centers in the coming times.

As we discussed last time also that the focus is on the procurement because selling here in India of dairy products is not very difficult, only if you have a good quality raw material, which is the raw chilled milk. Now that should all from my side. I would like to address any queries that you might have. Thank you.

Moderator: Our first question is from the line of Mayur Gathani from OHM Group. Please go ahead.

Mayur Gathani: Hi, Good morning everyone. Sir can you just give me some idea on the working capital days, debtors, creditors and the inventories that you hold?

Sidhant Gupta: If you see the working capital cycle as of now it stands almost around at 87 days, going forward as we are changing our product mix, as we move towards the branded product category as in the branded pouch milk and the curd and various cottage cheese this is going to substantially come down, as of now if you see last year almost 30% sales came in from unbranded milk where again these working capital cycle is more because in terms of the payment to the farmers which are creditors we are almost around 4-5 days because we have to make instant payments to ensure that milk keeps on coming to you whereas in terms of our debtors since we were predominantly an institution seller so the working capital cycle was higher but going forward that is something that the company understands and it is in fact you can see some trend reversal in this quarter and going forward in one year's time we hope to bring it substantially down to almost around 60 days.

Mayur Gathani: Can you give me the break up let us say 87 days is working capital, like the debtor days, the creditor days will you be able to give me a break up for that?

Sidhant Gupta: See creditor days almost outstanding is around 4 to 5 days, the debtor days are 87 days last year and I think this year it is anywhere between 80 to 85 days. Stock inventory that we are maintaining I think that is again at around 12 days because of the various SKU that we had launched in last two years time. If you see now in the ghee category we have three variants one is the normal ghee, the other is cows ghee and the third is Livlite which is 85% less cholesterol and in those three categories we have various SKU ranging from 10 gram Tadka pack as we call it to 15 kg.

Mayur Gathani: Will SKU give you higher margins?

Sidhant Gupta: Definitely that is what has been the trend and if you see last 2-3 years back where we were predominantly selling our products in to only the institution space and the consumer products were minimal but last two years we have been able to successfully launch various product categories and also open new market that is the only thing which has helped us in increasing the margin.

Mayur Gathani: But does that also increase the working capital with the SKU?

Sidhant Gupta: I think to begin with definitely yes, that is the case, in case of ghee that was something that we felt because when you had launched in the market the consumer products so you had to give better terms in the market but in the case of the fresh dairy products which is the liquid milk and curd and cottage cheese the advantage is that you are able to realize payment from the market maximum in 7 days and going forward in fact if you see we can actually work in these categories on a negative working capital cycle. So if you are making the payment to the farmer on the fifth day you can actually realize from the market the third because it is a highly perishable product so within 24 hours if you are able to collect milk from the farmers you have to give it in the market and then next 24 hours you are able to realize the payment, so going forward definitely it is going to change as the product mix changes.

Mayur Gathani: Can you give me the financial numbers I mean the debts, what is the current debt and what is the repayment plan then?

Sidhant Gupta: The current debt as of now that we have is predominantly it is only 40 Crores, I think is the long term CapEx which was taken for setting up the milk-chilling centers and around 475 to 480 odd Crores that is all working capital debt.

Mayur Gathani: Sir regarding the milk-chilling centers how many would you be owning right now?

Sidhant Gupta: See the milk-chilling centers the model is that these are all leased facilities where you partially make the investments to bring it up to your standard which is in terms of the laboratory set up and other things, silos and chilling as of now the company has almost around 20 odd milk-chilling centers across the four states and going forward next two to three years we plan to open around 150 such centers.

Mayur Gathani: That will be all leased, right?

Sidhant Gupta: The plants are all on lease. The MCC you have to do the tie up with all the cold storage owners in the interiors of the villages.

Mayur Gathani: Right sir. And in this industry is it normal to have a farm as well as the cows as well or is it just the guys just come and give you milk to the milk-chilling centers?

Sidhant Gupta: See there are various methods of collecting milk, (a) is through the contractors whereby you just tell them to give you the quantity of milk that you want and they would bring it to your plant you test that and in case the quality is right to accept it or otherwise reject it. The other method is that you go to the farmers and bring it directly from the farmers, procurement directly from the farmers which is the MCC model, all the milk-chilling center model and the third is if you own your organized dairy plants are the dairy farms but owning an organized dairy farm is much more viable these days as compared to last 2-3 years but you imagine just if have say 5,000 animals and they give you say on an average 10 liters milk you are able to procure only 50,000 liters of milk everyday whereas as of now we are handling almost on 17 lakhs liters. So the focus as of now is to procure it from the interior most villages from the farmers directly, going forward definitely it is a viable business but as of now our focus is only procurement from the farmers and not plan to own the dairy farm but that trend is definitely coming up with the milk prices going up, you see in Punjab in fact there is a large progressive dairy farm organization which has come up, which owns up to 500 animals because it is very difficult to find the right mix of animals.

Mayur Gathani: How is your Livlite ghee doing?

Sidhant Gupta: Livlite is doing fantastically well, the only challenge that we have here is that we can produce it only from one plant, since it is a patented technology and we do not want to do it from the leased plants but then yes going forward we are doing CapEx at our own facilities to increase this, the product has been very well accepted in the markets, it is doing very well.

Mayur Gathani: What could be the contribution in FY'13 from Livlite?

Sidhant Gupta: Well I will have to check but approximately we are doing almost around 8 to 10 Crores of Livlite every month. In fact we have just got the approval in Dubai so we will start exporting that also.

Mayur Gathani: How is the Dubai subsidiary doing Sir?

Sidhant Gupta: The Dubai subsidiary is doing fine. We had set up that in end November, in fact December we started the operation and we have already got the approval for our regular ghee and the Livlite, we will be starting that soon because there is a process that you have to follow you have to write in Arabic and other things so we have held on that and then also our existing clients like Britannia, Bikanerwala all those guys who are operating there they are also very keen to start the work. We have already started the work and we will be seeing some results soon.

Mayur Gathani: So what basically is your subsidiary in Dubai focusing on?

Sidhant Gupta: See basically as the export from India is banned and we were exporting earlier these skimmed milk powder to various countries like Bangladesh, Pakistan, Egypt, UAE itself so since the export is banned the value added products or the formulation that we were doing for various industries as in the biscuit industry or the ice-cream industry to service those clients we have set up that facility in Dubai. We have done the tie up

- with plant owners in Turkey and Poland who will be manufacturing as per our requirement. We are bringing it down to Dubai, doing the value addition there and then selling it across to various countries.
- Mayur Gathani: Have you put in any CapEx there Sir?
- Sidhant Gupta: As of now we have just spend almost on 2 Crores.
- Mayur Gathani: We are setting up plant, which will be just adding on?
- Sidhant Gupta: That is more of blending and repacking facility.
- Moderator: Our next question is from the line of Siddharth Bhattacharya from Suyash Advisors. Please go ahead.
- S. Bhattacharya: Hi, just a couple of questions form my side, if you could give us some sense of what revenues are your newly launched products doing or what contribution like Livlite is doing you said 8 to 10 Crores, what would be the other newly launched products and how are they doing in terms of quantitative numbers. Also I wanted to understand how difficult is the distribution part in the whole chain, so if you could throw some light on that?
- Sidhant Gupta: See the distribution of the normal products which is ghee and the skimmed powder is different and the distribution of fresh dairy products is absolutely different because you know the fresh dairy products they have to reach the shop before 6 o' clock and whereas in terms of the normal products that can go at any time so we have various distributors, a separate distribution network for the fresh dairy products which is the milk, curd and Paneer or the cottage cheese and for ghee and SMP and other products we have a different distribution network. In terms of the volume if you see we have able to touch a peak of 1.5 lakhs liters of liquid branded milk and in terms of curd if you see we are doing almost 6 tonnes of the bulk curd which is starting from 2 kg to 15 kg in a matka pack and for our pouch curd we are doing almost 3 to 3.5 tonnes on an everyday basis.
- S. Bhattacharya: When these products go to the retailer and if suppose they do not sell so how is it, is it on return basis? How does it work?
- Sidhant Gupta: See, normally what happens that in this industry people are actually we would do a booking before hand, say if we are going today, our salesman will do the booking for tomorrow. Guy would know how much he can sell and that is why we are also not pressurizing the market to actually start pumping more into their shops. So it is a slow process but then definitely he gets encouragement from the way people come and ask for the product. See, as I said, in dairy products the only challenge is the quality. If you have a good quality product then I think selling is not difficult. People actually come forward and are even ready to pay you a premium. That is what we have seen within one-and-a-half months of our launch of liquid milk in the pouch segment that we had nutrified we have got a fantastic response. In fact what we had thought was that we will touch almost 50,000 liters.
- S. Bhattacharya: This is 3x what you were expecting.
- Sidhant Gupta: Absolutely and if you see the Delhi market, now within Delhi we consume almost around 75,00,000 liters of liquid milk everyday, in Delhi NCR. So it is a huge market and if you see also the market, 80% is still unorganized. Other than cities, if you go to interiors or other places, there are still the unbranded products that you will get, and there is a clear cut tendency of people shifting from the unbranded to the branded segment.
- S. Bhattacharya: I understand this in the context of milk sales but curd and paneer, there would be some sort of returns, right because they are as perishable as milk, if not?
- Sidhant Gupta: See, if you see our cottage cheese, it has a shelf life of 15 days. In case of our curd it has again a shelf life of 7 days in the refrigeration condition. So, in terms of that I think they are fairly well placed.
- S. Bhattacharya: Also, what would be the contribution from newly these launched products, pouch milk, what kind of revenue?
- Sidhant Gupta: Pouch milk if you compare it with, as of now, if you see today, we are sitting on the best times in the dairy industry in terms of the procurement because it is the best flush that we have seen in the last four years. It is a cycle that you see in every four

- years will be peak and that is what we are seeing this time. So, as of now the realization is much better but then on an average, the realization in the pouch milk segment, range is anywhere between 6% - 8% gross margins.
- S. Bhattacharya: What about curd and paneer?
Sidhant Gupta: Curd and paneer are definitely slightly better, curd, I think, is almost around 12%-15% and in terms of cottage cheese also it is anywhere between 10% and 15% depending on the various markets.
- S. Bhattacharya: Could you throw some light on trying to distribute deeper into other newer geographies apart from NCR region?
Sidhant Gupta: See, as of now the focus for our fresh product will be only NCR because as I explained it is a huge market and in terms of our plant, it is just 50 km away from heart of city. Logistically it makes sense.
- S. Bhattacharya: Correct. So, logistically it makes a lot of sense to do it only in Delhi and then going forward we are looking at other various packing options. So, we will be setting up a tetra UHT tetra plant also.
- S. Bhattacharya: What about your Livlite product, that is on a national scale, right?
Sidhant Gupta: We have not been able to, in fact we thought that we would do it on a national scale but then since there was a handicap in terms of our production capabilities, we are focussed only on the northern regions.
- S. Bhattacharya: Currently it is available only in Delhi?
Sidhant Gupta: Northern regions.
- Moderator: Thank you very much. Our next question is from the line of Abhishek Jaiswal from Baljit Securities. Please go ahead.
- Abhishek Jaiswal: Hi, thank you for taking my question. Just have a couple of questions sir. First what will be your cattle feed side and the capacity utilization of it?
Sidhant Gupta: Capacity utilization last year was almost around 85%, a little more than 85%, in fact. See, it is a 24x7x365 day's industry. You cannot have holidays in dairy industry because the milk has to come and it has to be processed because of the highly perishable nature of the industry.
- Abhishek Jaiswal: What will be current level of cash in the books?
Sidhant Gupta: That I will have to actually check and I can come back to you on that.
- Abhishek Jaiswal: And the last question, you mentioned that you have entered into a contract with IRCTC; can you throw some light on the contract side and the duration of it?
Sidhant Gupta: Yes, see basically, how it works is that you have to get your product approved by the IRCTC and then you have to supply through contractor or the caterers and once your product gets registered, then it is for a very long period. There are no time frames of that and there are no contracts, it is only with the caterers that you have tie-ups and if you see in case of one caterer he wanted 50,000 cups everyday and we have just been able to give him 12,000 cups.
- Abhishek Jaiswal: So, there is a potential?
Sidhant Gupta: Absolutely, because Railways if you see, every day there are 50,000, in fact I do not know much more than that people who commute by Shatabdis and Rajdhanis, so I am just talking of one caterer who wants 50,000 and we are in fact supplying him only 12,000.
- Abhishek Jaiswal: So, it is like your supply is constrained to only Shatabdis and Rajdhanis or may be providing your supply to other trains?
Sidhant Gupta: See, basically it works in the fashion that the caterers decide and you are supplying to the caterer, so as I said that since the shelf life and the perishability of the product is such that you can only supply it to the near-by places, so our focus would be in Delhi NCR, so from Delhi whatever trains are originating from Delhi, so that is the normal system. They would just keep it and refrigerate it. You must have seen the meals, if you are traveling by Shatabdi and Rajdhani these days, you will find our Dairy Best curd in that.
- Abhishek Jaiswal: And last question, can you just give a brief detail of products that will be under the IRCTC caterer?
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- Sidhant Gupta: See, it will be to start with what we have got approved is the curd in 80g. Going forward we are also getting, in fact we have already got the approval for paneer, which is the cottage cheese and we have got the approval for dairy whitener, the small sachet that you get dairy whitener I think in one month's time we will be starting with our dairy whitener too.
- Moderator: Thank you very much. Our next question is from the line of Kaustubh Pawaskar from Sharekhan. Please go ahead.
- Kaustubh Pawaskar: Good morning sir. Thanks for taking my question. Few queries; first is can you give me break up of your revenues in terms of institutional business and branded business and query pertaining to that is when do you expect this revenue mix to improve, that is, branded business contributes more to your topline than the institutional business which will definitely improve your margin prospects going ahead. Third query is on the raw material prices, that is, milk and skimmed milk prices, do you expect some softening because of the best season you have seen for this year and fourth query after that I will ask.
- Sidhant Gupta: See, basically in terms of the milk pricing, if you see, we have already seen prices softening a lot and going forward in one month's time we only see prices going up rather than softening because the flush (ph) would get over in almost one month, so going forward, the prices are going to go up. In terms of our product mix as of now I think tentatively almost around 60 to 65% of the revenue would still be coming in from the institutional sale whereas 30% to 35% would be coming from the consumer products, see basically for converting that into the consumer products, again you need to have the best quality milk. If you have contractor's milk then you can definitely make commodities but you cannot make products, which are for direct consumption. Products like butter, like milk, paneer, curd, something like skimmed milk powder or ghee which is not to be consumed directly can be created from contractor's milk, so going forward, that is the focus the company has opening more milk-chilling centers so that we are able to procure the best quality milk directly from the farmers, now with that milk only you can create value added products and we hope to reverse this trend in next two to three years' time once the milk-chilling centers are in place and we are able to procure more than 60% to 70% of the consumption that we want directly from the farmers. Once we have those quantities, then definitely we can go in for all the branded products and the product mix will completely change.
- Kaustubh Pawaskar: Sir, my next question is on how is your contract with these farmers, basically these farmers, just wanted to understand how is the billing cycle and do you pay them on the basis of the quality or these are years' contract that you have to pay that much amount in this particular period? I just wanted to understand that?
- Sidhant Gupta: See, with farmers you cannot have contracts. It is on a five-day basis that you fix up the price of the milk and then they keep on supplying to you, there is no long terms contracts with the farmers. Nobody can enter into a long-term contract but in terms of the relationship that you have since you have been able to procure milk from them for a long time and what the company is doing a typically milk-chilling center, now how does that work within a radius of 25 to 40 km it caters to 120 to 130 odd villages. Each of the village, what you have done, you have given them integrated kits and the role of integrated kit is to give them the fair testing of the quantity and quality of the milk. See, milk payment is always based on the quality; it is never based on the quantity. Tomorrow if somebody puts in water, you will not be paying for the water. You will pay only for the quality which is determined by the fat and the SNF content that it has, so you have various tests and you have given them sophisticated machines to check how much is the quantity that he has brought in. It is all electronically weighed, which is linked to a stirrer which would actually shake the milk and make it even for you to test, then you have a testing machine within 30 seconds will give you a result as to what is the fat and the SNF percentage in that. That is linked to a computer, so farmer in five minutes gets a slip. That brings in a lot of transparency for the farmer and also you have tied up with veterinary doctors to provide them

- facilities. You are working on artificial insemination, you are providing the farmers with medical insurance, which they are bearing, but then you are taking the cover. Then also you have tied up with cattle-feed owners to provide them cattle-feed at a no profit no loss basis depending on our expertise which is based on the breed of the farmer and also the season. So, all those things put in together, the confidence farmers generates is that you are a plant owner, you are making a fair testing, you are giving him payments on time. So, all these relationships that work rather than, you cannot have fixed contracts with them.
- Kaustubh Pawaskar: And sir my next question is, is a general question on the demand supply of milk in the domestic market. So, how is the scenario over there and is there any mismatch between the demand and supply?
- Sidhant Gupta: Yes, definitely if you see the nature of the industry, dairy industry is worth 5 lakh Crore which is growing at 9% and the production is going up by 3%. We are the largest consumers of dairy products in the world. We are also the largest producers of dairy product. We have the largest amount of the herd population in the world, but then still the difficulty is that our per animal production is just 4 liters against an average of 9 liters per animal and the holding per farmer is just two animals, so that is why it makes it difficult and the nature of the industry is just unorganized; 80% is still unorganized. It is all the unbranded. You will not see cottage cheese branded at most of the places. So that is the nature of the industry. So there is a huge demand. In fact we consume 110 million tonnes of dairy products every year. We need 6 million tonnes more whereas in last ten years the production has gone up by just 3.5 million tonnes. These are all statistical figures; there is a lot to do in this industry.
- Kaustubh Pawaskar: My question is more in terms of how the pricing scenario would be going ahead. So, you do not expect pricing to soften?
- Sidhant Gupta: No, they will only firm up in the coming times because you are already sitting in the flush season. They are only going to go up now further.
- Kaustubh Pawaskar: But sir, are we taking any steps or measures to improve this quantity per animal to improve?
- Sidhant Gupta: Absolutely. That is what I was saying that we have tied up with veterinarian doctors providing them cattle feed, educating people, sending them for training programs. So, all those things will only ensure, in fact the government is also coming up with a National Dairy Plan 1 where they intend to spend something like 17,300 Crores to increase the milk production and they have already started that. In the 12th Five year plan, in fact the focus is a lot on the dairy and farmers.
- Kaustubh Pawaskar: Where do you see this working capital cycle, you just mentioned that it stands at around 87 days currently, where do you see going ahead this working capital cycle to go to improve, around 75 days?
- Sidhant Gupta: No, it will come down even more. See, significantly, as and when you are into the fresh dairy products, the working capital cycle will improve because it is only a function of how often you are servicing your retailer. In case of fresh dairy products, you are servicing him on an every day basis. So, obviously he will only place you a fresh order once he has been able to dispose of the previous stock that he has so the realization is much faster.
- Kaustubh Pawaskar: Sir, do you expect this debt level of 480 Crores to reduce in the coming years?
- Sidhant Gupta: Absolutely. Now this is a kind of peak that it has touched. It is only going to come down and that is why the focus more is on the fresh dairy products.
- Moderator: Thank you very much. Our next question is from the line of Mangesh Kulkarni from Almondz Global. Please go ahead.
- Mangesh Kulkarni: I just wanted to know what is the margin going ahead with the increased focus on the branded products?
- Sidhant Gupta: See, as I was discussing that last year if you see, almost 30% of the revenue came from the unbranded milk that we were selling in loose tankers. There the company was making almost around 3% - 4% gross margin. Going forward as and how you are converting that into the pouch milk which is the branded segment the likelihood of

margins improving almost to 6% - 8% are there but there will be a tremendous increase in the margins and also the working capital cycle will come down drastically.

Mangesh Kulkarni: Sir, how this working capital cycle will come down?

Sidhant Gupta: Because in case of the fresh dairy products, as I was explaining in case of fresh dairy products, you are servicing the retailer on an everyday basis. Milk is something, which is consumed everyday. So, your salesman will service the retailer on an everyday basis. He would only place the order for the next day if he has been able to sell his previous stock whereas in case of ghee probably the sales happen once in a month or twice in a month. So, that is the difference. In case of fresh dairy products, the realization from the market is much faster.

Moderator: Thank you very much. As there are no further questions from the participants, I would now like to hand the conference over to Mr. Harjit Singh Sethi for closing comments.

Harjit Singh Sethi: On behalf of Almondz Global Securities I thank Mr. Sidhant Gupta for his valuable time in providing insight about the company. I am sure this will help our investors as well as analyst's community, this interaction. I would also thank all the participants for joining the call. Thank you, have a very nice day.

Moderator: Thank you very much sir. On behalf of Almondz Global Securities that concludes this conference call. Thank you for joining us and you may now disconnect your lines.

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